Quaker
BioVentures

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Via Email

January 24, 2010

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
Station Place, 100 F Street, NE.
Washington, DC 20549-1090
Rule-comments@sec.gov

RE: ***Release No. IA-3111; File No S7-37-10, Exemptions for Advisors to Venture Capital Funds, Private Fund Advisors with Less Than $150 Million in Assets Under Management, and Foreign Private Advisors***

Dear Ms. Murphy:

On behalf of Quaker BioVentures, a Philadelphia-based advisor to life science venture capital funds (Quaker BioVentures), I am pleased to provide comments to the Securities and Exchange Commission (SEC) regarding the proposed rules on exemptions for advisors to venture capital funds (VCFs).

Quaker BioVentures manages five VCFs, with $700M in aggregate assets under management. All of our VCFs invest exclusively in healthcare and life sciences companies, including biopharmaceuticals, medical technology, diagnostics, research tools and equipment, and healthcare services companies. We invest across many stages of a company's life cycle and development, including raw startup, preclinical research and development, early and late stage clinical development, and early commercialization. We have approximately 35 active portfolio companies, almost all of which are based in the Mid-Atlantic and Southeastern regions of the United States.

The creation and maintenance of a robust environment for venture capital investment in life sciences companies is critical to a healthy, innovative, U.S. economy. VCFs provide the capital that is absolutely necessary to advance innovative medical technologies from major NIH funded academic medical centers through the early stages of applied research and development, and eventually to products that are approved by the FDA and available to the market. Our companies regularly create hundreds of skilled, high-paying jobs. Our companies are almost never profitable until some time after their products are commercialized, often a decade or more after our initial investment, and they depend heavily on the equity capital available to them from VCFs until profitability. Simply stated, without a robust life sciences venture capital industry, the United States would not be a world leader in biotechnology and medical devices – in fact, virtually every successful publicly held biotechnology company had critical financial support from venture capital at some point in its development.

Quaker BioVentures appreciates the efforts of the SEC in establishing a proposed definition for "Venture Capital Fund" (or VCF) and "Qualifying Portfolio Company" (or QPC) as directed by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Establishing a proper definition is very important to the continued availability of venture capital to hundreds of innovative, emerging life sciences companies.

We offer the following specific comments:

1. Support for Comments of the National Venture Capital Association

Quaker BioVentures is a member of the National Venture Capital Association (NVCA), and I am currently serving on the Board of Directors of NVCA. We have reviewed the Comment Letter submitted to you by the NVCA on January 13, 2011, and are supportive of the comments made in that letter. However, the comments of the NVCA are of necessity broadly representative of the venture capital industry as a whole and we (and the letter from the Biotechnology Industry Organization referred to below) wish to emphasize the critical special needs of life science venture funds, and the life sciences industry that depends on venture capital.

2. Support for Comments of the Biotechnology Industry Organization

Quaker BioVentures is a member of the Biotechnology Industry Organization (BIO). One of the Quaker BioVentures partners is currently Chairman of the Board of PABIO, the Pennsylvania state-level affiliate of BIO. We have reviewed a draft of the Comment Letter which will be submitted to you by BIO on January 24, 2011, and are supportive of the comments made in that letter.

3. Expand Permissible Level of Non-Qualifying Investments

We submit to the Commission that instead of the proposed 15% "basket" level of permissible non-qualifying investments recommended in NVCA's comments, a more appropriate level of permissible non-qualifying investments would be in the range of 30%. There is ample precedent within related rules of the Commission demonstrating the appropriateness of a larger basket of permissible non-qualifying investments in similar situations, including, as most relevant for purposes of the current proposal, the ability of a Business Development Company to invest up to 30% of its assets other than in those sanctioned by Section 55 of the Investment Company Act of 1940. In fact, this allowance was increased by Section 202(a)(22) of the Investment Advisers Act of 1940 to 40% for purposes of that Act. Another example is Section 3(c)(5)(C) of the Investment Company Act (with respect to which the SEC Staff has stated that in order to be "primarily engaged," an issuer must invest at least 55% of its assets in mortgages and other interests in real estate and an additional 25% of the issuer's assets in real estate related assets, while the remaining 20% may be invested in non-qualifying investments).

Because of the speed with which venture capital investors and portfolio companies must sometimes adjust to their circumstances, it is appropriate to provide for a basket of non-qualifying assets that is as large or larger than those provided in other regulations. We believe that doing so would not pose additional investor protection concerns or systemic risks, while allowing greater flexibility on the part of VCFs to provide capital in a manner appropriate to the specific circumstances of venture-stage companies.

4. VCFs Should Be Permitted to Invest in Certain Types of Public Securities

There is widespread misunderstanding, particularly with respect to the life sciences industry, of how VCFs interact over time with the public markets. The old model assumed that VCFs would provide multiple rounds of private financing before a company went public, and that public investors (mutual funds, hedge funds, and other public institutional investors) would provide any necessary financing after a company's IPO. Unfortunately, however, the lines in practice are far from being so clear-cut, and today the typical life sciences IPO is more of a financing than an exit event for the venture capital backers.

The sources cited by the SEC's proposal recognize that VCFs do invest in publicly traded companies. For example, note 56 quotes Jack S. Levin, *Structuring Venture Capital, Private Equity and Entrepreneurial Transactions*, 2000, at 1–4, stating that "in the relatively infrequent cases where the investment is into a publicly-held company, the [VCF] generally holds non-public securities." While this may be relatively infrequent over the entire venture capital industry, it is actually frequent for venture investments in certain industries, such as life sciences.

Indeed, without the ability of VCFs to purchase and hold publicly traded stock – purchased directly from the Company – many life sciences companies would never be able to access public markets at all. Certainly in the sharply down IPO markets of the past several years, there are several ways that VCFs have often been called on to support companies going public, and portfolio companies once public.

First, of course, all major underwriters insist on "lock up" agreements by the VCFs, under which public selling of privately acquired stock is prohibited, typically for 180 days following the IPO. After the expiration of the "lock up" agreement, actual liquidity is often extremely limited, and trading volumes are very thin. As acknowledged by the SEC's proposing release, in the text accompanying note 75, many VCFs continue to hold privately acquired stock, often for many years after an IPO. We agree that allowing VCFs such flexibility is critically important, because VCFs need to wait until there is better actual liquidity, or until an event such as an acquisition provides liquidity. VCFs should be able to continue holding privately acquired stock in companies that go public for an indefinite period of time without such holdings being considered non-qualifying.

Second, however, underwriters often insist that VCFs commit to purchase a large portion of the IPO itself as a condition of such an offering, and in recent IPOs such as those during 2010 of our portfolio companies, Tengion and NuPathe, the amount of the IPO required to be purchased by VCFs has ranged from 15-50% of the entire IPO. VCFs should be permitted to hold stock acquired in IPOs indefinitely without becoming non-qualifying. VCFs should be permitted to purchase an unlimited amount of securities in any IPO of an issuer whose securities are already held by the VCF.

Third, VCFs are often the only sources of capital available to smaller publicly traded companies for follow-on offerings, registered direct offerings, and PIPE transactions. VCFs should be permitted to purchase and hold securities, whether technically registered, or privately issued and subsequently registered, in such placements and offerings. PIPE transactions are especially important in life sciences. There are a substantial number of VCFs, including Quaker BioVentures, who lead and participate in very significant direct issuer PIPE transactions with public issuers.

For example, along with three other VCFs in August 2010, Quaker BioVentures co-led and participated in a $50 million PIPE transaction for a relatively seasoned public issuer whose market capitalization before the PIPE transaction was approximately $100 million. The issuer believed that there was not a viable source of alternative capital in that amount. We and the other three VCFs conducted extensive due diligence over a number of months under confidentiality agreements, much like we would conduct in the case of a privately held issuer. Two of the four VCFs took board seats and are very actively involved in the development of the company. The previously mentioned company is developing several breakthrough products to treat serious viral infections affection tens of millions of people worldwide. Research on these products has been underway for the better part of a decade, and more than $250 million has been invested in research and development to date. FDA approval for the most advanced product is not expected for at least five more years, and hundreds of millions of additional dollars will be required to get the product to patients. Life science investors need the ability to invest over many years and in multiple financial instruments in order to move life saving products through the development and regulatory approval process. Quite simply, these companies (and the innovative technologies they develop) will not survive without venture capital investment at all stages in today's financial environment.

It is critical that there be some flexibility built into the proposed qualifying activities for VCFs to lead and participate in PIPE and other follow-on transactions of publicly traded issuers. If this avenue to capital is cut off to publicly traded life science companies, there will be very widespread ramifications for the financial health of that entire industry sector, as VCFs are forced to decide between registration and making that class of investment. We propose that the SEC consider allowing VCFs to invest without limit in securities of publicly traded companies in circumstances where (1) the company's market capitalization is less than $200 million; (2) the investment is not syndicated by a principal underwriter; (3) the amount of the investment is large relative to the value of currently outstanding securities of the issuer, for example in excess of 25% of the issuer's market capitalization; and (4) the purchase is made directly from the issuer.

We propose that the suggested qualifying activity be limited to transactions with the issuer directly, in which the company receives new capital from the VCF, and that the suggested qualifying activity not extend to any open market, or investor-to-investor transactions, because these transactions do not provide new capital for the underlying company. We believe that because VCFs are limited in the amount of borrowing they may undertake, such transactions would entail minimal systemic risks, and no additional investor protection concerns are raised. We also propose that with respect to PIPEs and other issuer transactions, including the IPO, that the qualifying activity not be limited to companies already in the portfolio of the VCF, but also be extended to new companies as well. Based on the stage of development typical in the life sciences industry, these are still legitimate "venture" transactions, providing critical capital not otherwise available through the public markets, and should be encouraged as a matter of national policy, not discouraged.

5. Provide Flexibility for Qualified Portfolio Companies to Incur "Venture Debt"

Many VCF-backed portfolio companies incur "venture debt" in the normal course of their operations, and there should be flexibility built into the proposed rules to permit VCFs to invest in portfolio companies that take on such debt. This debt is typically term debt with an original maturity of 30 – 60 months, often with an initial interest only period, and is in small amounts relative to the equity capital backing the company. The venture debt providers often take warrants on equity in the portfolio company, and often underwrite an "equity like" case in considering the proposed debt. The purposes of the venture debt include: "extending the runway" for subsequent financing requirements for the achievement of important milestones, providing financing for extremely expensive scientific equipment, supplying working capital for a revenue producing company as they approach profitability, and a variety of other purposes. It is well understood that the source of repayment of venture debt is existing or future equity financing from VCFs, non-dilutive financing sources such as government and other grants to the portfolio companies, cash from licensing of technology and strategic corporate partnerships, and funds from operations, in the case of revenue producing companies. The amounts of venture debt incurred are rarely significant compared with the underlying equity base of the companies, and will not pose any systemic risk, either individually or in the aggregate, to our national financial system.

In our view, incurring typical levels and types of "venture debt" should be a permitted activity of QPCs, and should not disqualify a portfolio company from that permitted to VCFs.

We hope that these comments are useful to the Commission in its consideration of revisions to the proposed rules. We urge the Commission to consider these comments, and those of the National Venture Capital Association (NVCA) and the Biotechnology Industry Organization (BIO) carefully. We would be pleased to provide additional input on these or other matters, and we would be happy to meet with the SEC Staff to discuss any of these matters. Please do not hesitate to contact me at 215.988.6811 or sneff@quakerbio.com.

Sincerely yours,

Sherrill Neff

P. Sherrill Neff
Partner